

**MILWAUKEE COUNTY**  
**BOND SALE PROCESS, DOCUMENTATION AND PAYMENT**  
**REVIEW**  
**FOR**  
**COUNTY BOARD OF SUPERVISORS**



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Virchow, Krause & Company, LLP is a Wisconsin consulting, auditing and accounting firm. Virchow, Krause was retained by the Milwaukee County Board through the office of Internal Audits to conduct an analysis of the process, documentation and payments relating to a debt restructuring the County conducted in 2003 (General Obligation Refunding Bonds, Series 2003A). The specific scope of services for this analysis was limited to the following (see Professional Services Contract dated July 16, 2004):

- Evaluate the appropriateness of the process used in December 2002 to select Bear, Stearns & Co., Inc. as the firm to provide Milwaukee County with underwriting services for a bond refunding in June 2003.
- Evaluate the appropriateness of the documentation maintained by the Department of Administrative Services for the above selection process.
- Review fees obtained by Bear, Stearns & Co., Inc. for the above-referenced underwriting services to determine compliance with amounts as bid by the firm and approved with authorization of the bond refunding by the Milwaukee County Board of Supervisors.

The contract between Virchow, Krause and Milwaukee County was entered into on Friday, July 16, 2004, with a report due to the Finance and Audit Committee of the County Board of Supervisors on Thursday, July 22, 2004. Given the short period of time available for this analysis, the following findings, conclusions and recommendations are based on the information that was available and the individuals we were able to contact in this short timeframe. New information may come to light during more lengthy reviews being conducted by others that may materially affect this report. Furthermore, if disputes arise as to any factual statements presented herein, they should be confirmed independently by the County.

## **BACKGROUND**

In the fall of 2002, as the County was attempting to develop its 2003 Annual Budget and address significant financial shortfalls, it was suggested that the County take advantage of then low interest rates and refinance some of its outstanding debt to reduce annual principal and interest payments. A Request for Proposals (RFP) was prepared and sent to interested investment banking firms to provide services to the County for the sale of refunding bonds in an amount not to exceed \$115 million. Based on the RFP, the County received eight (8) proposals, from the following firms:

A.G. Edwards  
George K. Baum  
Loop Capital Markets  
Stifel Nicolaus

Bear, Stearns & Co., Inc.  
Lehman Brothers  
Siebert Bradford Shank  
US Bankcorp Piper Jaffray

The bid process was administered by Pam Bryant with the Department of Administrative Services. The normal Professional Services bidding process is outlined in Section 56.30 of the County Code. The Code includes in its definition of *Professional Services* "...services customarily rendered by...financial personnel...and other consultants...." However, the code exempts the county executive, county board and department of administrative services "...for the purpose of securing credit rating and fiscal agency services related to debt issuance and administration" (emphasis added).

Notwithstanding this exemption, it appears the Department of Administrative Services (DAS) substantially followed the requirements of Section 56.30 of the Code. A RFP review panel was created, as is the usual practice of DAS, to review the proposals and recommend a firm to which to award the project. The review panel consisted of representatives of DAS, Department of Audit, Corporation Counsel, Disadvantaged Business Development and the Controller. Each panel members was given copies of the proposals (without bid prices) and evaluation forms to be completed after reviewing the proposals (copy of an evaluation form is attached). The evaluation form rated the following criteria:

1. Responsiveness to the Request for Proposal (15 points maximum)
2. Location, Experience and Qualification (30 points maximum)
3. Results of Analysis (25 points maximum)
4. Cost Proposal Summary (30 points maximum)

The panel members scored the proposals for criteria 1 and 2. Pam Bryant, with advice from Robert W. Baird & Co. provided scores for criteria 3, which is the firms' technical abilities and calculation of present value savings, and criteria 4, which was a weighting of the price quotation. The scores for criteria 3 and 4 were provided to the Panel members and then added to the scores they individually developed for criteria 1 and 2. The Panel met in December, at which time Pam Bryant asked each Panel member how they "ranked" each firm that submitted proposals (from first to eighth). She then listed the rankings on a whiteboard and after ranking all of the firms copied the rankings to a piece of paper. This tally of rankings showed Bear, Stearns & Co., Inc. the unanimous choice of the Panel.

This recommendation of the Panel was then presented to the DAS Director who in turn presented it to the County Executive. Both then recommended to the County Board awarding of the contract for this bond refunding to Bear, Stearns & Co., Inc.

The documents were subsequently filed away in the DAS offices and a controversy arose when they could not be produced upon receiving an open records request from the Milwaukee Journal Sentinel.

## **FINDINGS**

We reviewed the file documents related to this matter, including the following: "Green File", July 16, 2004 memo from the DAS Director (and attached supporting documents), County Procurement Code (56.30), completed evaluation forms, tally sheet, bond resolutions, committee and board minutes. We also interviewed several members of the review panel, County internal audit staff, the County's financial advisor, assistant district attorney and DAS staff.

Based on the information we were able to obtain in a very short period of time, we find the following:

1. The procurement of investment banking services was obtained through an open RFP/bid process that resulted in the County obtaining eight (8) qualified proposals.
2. The proposals were reviewed by a review panel which is consistent with the County's past practice.
3. The review panel rated proposals utilizing a numerical scoring process.
4. The County Financial Advisor assisted in the scoring process by assisting Pam Bryant in understanding the technical ability and the price quotations of the firms that proposed.
5. The Financial Advisor appears to have recommended that the Takedown charges be the basis of price evaluation but did not include other charges the firms may have included in their proposal.
6. The proposals were ranked in numerical order by the review panel.
7. The rank order of the proposals was tallied by Pam Bryant at a December 2002 review panel meeting.
8. The tally sheet shows Bear, Stearns & Co., Inc. to be the unanimous recommendation of the review panel.
9. The DAS Director was advised that Bear, Stearns & Co., Inc. was recommended by the review panel for county board approval.
10. The Director shared that recommendation with the County Executive.
11. The County Finance and Audit Committee was told that Bear, Stearns & Co., Inc. was recommended to be retained to assist the County in the sale of the refunding bonds and that the price in the proposal was \$3.69 per \$1,000 of bonds sold, but that the price may change based on market conditions at the time of actual sale.
12. The Committee requested final costs be presented to it once they are known.
13. The County Board approved the resolution to retain Bear, Stearns & Co., Inc. at its December 2002 meeting.
14. While the resolution to retain Bear, Stearns & Co., Inc. was passed by the County Board in December 2002, the actual bonds were not sold until July 2003.

15. A report was submitted to the County Board in June 2003 indicating that the Bear, Stearns & Co., Inc. fee was \$3.89 per \$1,000 of bonds sold. This difference from the original price quote based on a bond sale of \$100,025,000 amounted to an increased payment of \$20,398. The change in the rate per \$1,000 of bond issued was reported to the County Board, however, the increased payment (dollar amount) does not appear to have been communicated to the County Board.

## RECOMMENDATIONS

Generally, based on the information we were able to generate in this shortened review process, the County has an acceptable bidding, review and award process in place. However, there are areas where the process could be improved to elevate the public's confidence to the procurement of professional services for bond transactions.

### A. Appropriateness of the Process:

1. The County should continue to have professional services proposals such as those in this instance reviewed and evaluated by a review panel with diverse backgrounds. The review panel should score proposals based on criteria included in the RFP. In this instance, questions have been raised about the weight given to each criterion. In general, the weight appears reasonable. The fact that the review panel scored only 45 of a possible 100 points is not entirely accurate. The weighting of price is a mathematical calculation that is based solely on bid price. Thus the review panel is in fact scoring 45 of 70 points.
2. Some individuals have questioned whether or not the weight values given the evaluation criteria is appropriate. Specifically, should price have been given 30 of 100 points. We have seen similar weighting values in other proposals for professional services and have not seen it as a significant issue. We have no recommendation for changing these weighted values.
3. Currently the financial advisor assists the County in ranking technical qualifications and price. As stated above, price is a mathematical calculation. Ranking technical qualifications is more subjective. We would recommend that this criterion be ranked by the financial advisor and at least one other independent person with appropriate. This could be someone from the Budget and Finance Department, Internal Audit or even a volunteer citizen with such expertise.

4. In evaluating and comparing prices submitted in proposals, all price components should be considered. In this particular case only the Takedown price was used to compare the proposals and management fees, underwriter's fees and expenses were excluded, even though they were specifically included in the RFP. In instances where the total price is not the appropriate criteria to use, there should be a written explanation of the reasons for deviating from normal practice.
5. The RFP required among other things that bidders "commit" to a *management fee, underwriting fee, underwriter's expenses and Takedown* (see Section III, F of RFP) and "*The spread for management fee and underwriting fee, if any, will be considered firm and not subject to change*" (see Section IV, 9 of RFP). A reasonable person making a reasonable interpretation of these two requirements would conclude that the Bear, Stearns & Co., Inc. proposal did not comply with these requirements of the RFP. We recommend that in order for a proposal to be considered, it must comply with all requirements of the RFP, this does not appear to be the case in this instance, even though the RFP states; "*Failure to respond to a specific requirement may be basis for elimination from consideration during the comparative evaluation*" (Section II, F of RFP). If it is determined that a proposal materially complied with an RFP, but there were deviations, there should be a written report on the reasons for any deviations.

**B. Appropriateness of Documentation:**

1. Rather than having review panel members report the scores they assigned to each proposal, they were asked for the rank order from 1 to 8 of the proposals. The ranking numbers were then added up to determine who ranked highest. We recommend that the scores be added up to determine who received the highest score for recommendation of award, so that subjectivity can not over ride a numerical ranking.
2. Of the review panel members we talked to, only two members still had their score sheets which were neither completed nor signed. We recommend that the score sheets be completely filled out, signed and dated by the review panel members.

3. The rank order of the proposals was tallied on a whiteboard for all to see and then transcribed to a sheet of paper. The tally sheet is the only record of the decision reached at the meeting of the review panel. We recommend that minutes of the meeting be taken, creating a record of both the discussion of the proposals and the decisions made. Further, we recommend that the panel members score sheets be collected and retained in the file as supporting evidence of the decisions made.
4. Once the review panel makes its recommendation, the recommendation is passed on to the DAS Director. In this instance, it was done orally. We recommend that the review panel's decision be given to the Director in writing with said report showing the ranking and scores of all proposals, along with a copy of the minutes of the review panel meeting.
5. A public controversy arose when documents could not be produced timely after a public records request. However, it was discovered that the records were apparently misfiled and subsequently located. We noted that the county has a records retention policy in addition to the State Statute regarding public records. Some County employees interviewed were not aware of these requirements. We recommend that basic training on these requirements be provided to employees who are responsible for records.

C. Review of Fees Paid to Bear, Stearns & Co., Inc.:

The Bear, Stearns & Co., Inc. proposal, dated November 29, 2002, and final pricing information included the following fees:

	2002 <u>Proposal</u>	2003 <u>Final Pricing Information</u>
Management Fee	\$0.00*	\$0.40000
Takedown	\$3.00	\$3.00000
Underwriter's Fee	\$0.00	\$0.00000
Expenses	<u>\$0.69</u>	<u>\$0.49393</u>
<b>Total</b>	<b><u>\$3.69</u></b>	<b><u>\$3.89393</u></b>

\*Management fee of \$0.00 to \$1.00/bond based on the scope of work and timeframe to execute for refunding transaction. (Excerpt from Bear, Stearns & Co. Inc. proposal)

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These differences in fees, as shown below, resulted in an increased payment to Bear, Stearns & Co., Inc. in the amount of \$20,398.

	Per Bear, Stearns & Co., Inc. Proposal	Pricing Information from Bear, Stearns & Co., Inc.
Underwriting Fee	\$ -	\$ -
Underwriter's Expenses	\$ 0.69000	\$ 0.49393
Takedown	\$ 3.00000	\$ 3.00000
Management Fee	\$ -	\$ 0.40000
Total Underwriter's Spread	\$ 3.69000	\$ 3.89393
Total Amount Borrowed	\$ 100,025,000 divided by \$1,000	\$ 100,025,000 divided by \$1,000
Total \$1,000's borrowed	\$ 100,025	\$ 100,025
Total Underwriter's Spread (rounded)	\$ 369,092	\$ 389,490

According to the Resolution Approving the Underwriter for General Obligation Refunding Bonds, Series 2003A and the report to the County Board of Supervisors dated December 16, 2002, the underwriters were to receive a maximum of \$3.69/\$1,000 of bonds issued for underwriting fees and expenses related to the issue. Both documents also stated that the "actual compensation will be negotiated based on market conditions on the day of the bond sale." According to the tape of the December 16, 2002 finance committee meeting, it was requested by a committee member that if the fee changed subsequent to this approval (12/16/02) that the committee be notified of this change. On June 18, 2003 in a final report to the County Board of Supervisors the new fee of \$3.89 was presented. There was no comment that there was an increase in fee or an explanation as to why the fee increased; however in the Adopted Resolution Authorizing the Sale of General Obligation Refunding Bond Series 2003A the total fee at the new rate was included in Exhibit B.

**Recommendation:**

In reviewing the fees paid to Bear, Stearns & Co., Inc. for the underwriting services connected with the Sale of General Obligation Refunding Bond Series 2003A the amount appears to be in compliance and within the range of the amounts included in the Bear, Stearns & Co., Inc. proposal dated November 29, 2002.



Regarding the amount approved by the County Board of Supervisors/finance committee, the Resolution adopted on December 16, 2002 approving the Underwriter included a fee of a maximum of \$3.69/\$1,000 of bonds issued. In the final Resolution Authorizing the Sale of General Obligation Refunding Bond Series 2003A the new total fee of \$389,490 was approved (\$3.89/\$1,000 of bond issued). The reason for this increase was the addition of a \$.40/\$1,000 of bond issued Management Fee and a \$.20/\$1,000 of bonds issued reduction in Underwriter's Expenses. This change in fee does not however appear to have been clearly communicated to the finance committee or County Board of Supervisors nor does it appear to have been explained. Finally, it was reported at the December meeting of the County Finance and Audit Committee that the final fees charged would depend on "market conditions at the time of sale." This would be true for Takedown charges, but market conditions should not affect a change in Management Fees.

Since six months had transpired between the time the proposals were received and the actual bond sale. During this time period the structure of the bond sale changed which appears to be one of the causes of an increase in costs for Bear, Stearns & Co., Inc. We do not think it is a reasonable expectation for elected officials to have remembered the original price quotation from six months earlier. Therefore, we recommend that a more complete report be given to elected officials that outline all material changes in conditions prior to final actions being taken by elected officials. In this case in particular, it would have been helpful to have included in the June 18, 2003 report the fact that the original fee was \$3.69, the new fee was \$3.89 along with a discussion of the negotiations that took place that resulted in the change in fees and the specific reasons for the change.